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An Overview of Microfinance in Latin America

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When it comes to evaluating its effects, supporters see growing numbers of clients and enterprises, but the economic mainstream has long held that its economic impact is minimal. The evidence, as ever, is not clear cut.

**What is microfinance?**



Bolivia\_BancoSolInterior

Microfinance most often refers to a range of financial services including credit, savings, insurance, money transfers, and other financial products provided by non-traditional service providers, targeted at people on low incomes. Microcredit in more specific terms are loans that can be accessed by people without proof of income or collateral (goods or property they can use to guarantee the repayment of the loan).

Typical microfinance clients are people living on low incomes who cannot access formal financial institutions. Microfinance clients are often self-employed, household-based entrepreneurs. Their diverse "microenterprises" include street vending, artisan manufacture and service provision. In rural areas, micro-entrepreneurs often have small income-generating activities such as food processing and trade.

Many institutions target women for a variety of practical and ideological reasons. Women are assumed to be more responsible and more likely to repay their loans as agreed. The ideological reasons include empowering women and supporting them to become less economically dependent on men while valuing the economic activities they already engage in. Research has also shown that women are more likely to invest in areas such as nutrition and education thereby improving the health and situation of family members. So, investing in women, is seen as a way of investing in the future.

**History of microfinance in the region**

Brazil was the pioneer country in Latin America to develop microfinance in the 1970s. Despite the difficult social conditions in many countries because of dictatorships, microfinance expanded throughout Latin American countries from the 1980s onwards, creating new organizations and ways of working to address the problems in each country. These new methodologies were at first developed mainly by non-governmental organizations (NGOs) and remained outside the formal financial system. A notable exception was BancoSol, a Bolivian bank fully dedicated to microfinance, which began operations as early as 1992. Yet overall, the recognized institutions in microfinance are NGOs such as FINCA (Foundation for International Community Assistance) who have accumulated experience and know-how.

Yet, as microfinance has expanded in the region, a great variety of types of lenders have emerged. NGOs have been joined by banks, credit unions, state institutions, foundations and private business. In some countries, such as Bolivia, Peru or Honduras, the regulatory authorities have created specialized non-bank charters for lenders. These are supervised financial institutions that need to comply with the regulations set forth by the corresponding financial authority. The most significant difference between a microfinance provider and a bank is usually lower capital requirements (sometimes significantly lower) and a limited number of services being provided. While NGOs still provide the bulk of lending, in some of the countries where microfinance is more recent, such as Argentina, private banks and state institutions are more prominent in microcredit lending.

**Microfinance in numbers**

In 2012, the Inter-American Development Bank (IDB) reported that the total loan portfolio of the Latin American and Caribbean microfinance industry came to US$12.3 billion at the end of 2009. Peru led the ranking with a US$3.2 billion microcredit portfolio, followed by Ecuador (US$1.7 billion) and Colombia (US$1.4 billion). The regional average microloan was US$1,200, averaging a 29% annual interest rate. The IDB itself was one of the main sources of funding for microfinance projects across the region and a keen supporter of the sector.

Latin American and Caribbean microfinance institutions had approximately 10.5 million borrowers at the end of 2009. Mexico had the largest market in the region, with 2.3 million clients, followed by Peru (1.9 million clients) and Colombia (1.4 million clients). Recent years have seen a tremendous growth in microfinance, as the number of users went from around 6 million in 2005 to nearly eleven million. Two thirds of clients were reached by regulated financial institutions. Through national household surveys, the IDB calculated that 4.5 million borrowing households were connected to a microenterprise (probably microfinance clients), while an overlapping number of 8 million has overall access to credit in the region.

Despite the growth over the past three decades, experts estimate that microfinance is only available to about 1 in 6 potential clients in Latin America and the Caribbean. These rates of coverage vary widely from country to country. In those with the longest experience, such as Bolivia or El Salvador, as many as 1 in 3 potential clients are served by microfinance institutions. In countries where the industry is less developed, such as Argentina or Venezuela, less than one in 20 potential clients have been reached.

**Profits and microfinance**

The increasing importance of the microfinance sector to the larger economic outlook in developing countries was underlined by the 2011 report by the Economist Intelligence Unit into the state of microfinance around the world. The research that went into the report highlights the growing business case for microfinance: high returns. The report, called the Global Microscope on the Microfinance Business Environment, found that eight of the top dozen countries with the best business environment for microfinance are in Latin America.

Microfinance expert Marguerite Berger sets out the changes experienced in the sector: 'microfinance has gone from an obscure development experiment to a multibillion dollar enterprise bringing banking to millions of people.' And specifically in relation to Latin America, she says, 'institutions in the region stand out for their integration into the formal financial system and their impressive growth, outreach and profitability indicators.' Thus microfinance has become an important component in the economies of many countries in the region, and one that keeps growing.

The fact that the poor have turned out to confound prejudice and been extremely good at managing and making money, given minimal opportunities, is paradoxically a reminder that many are too poor to be helped by small loans. In 95% of cases, repayments are met, showing those receiving these loans are very capable of managing risk considering their limited resources. While microfinance can help those who can absorb credit into an existing activity, this still leaves many people too poor to help themselves. For them, social policy experts are calling for a simple recipe: just give money to the poor. The effects of cash transfers, as they are called, have been similar to microfinance across the region. Recipients have invested the cash in welfare and education to rise above the poverty line. These programs are a reminder that there is still a role for the state in distribution and welfare, before market solutions such as microfinance can be workable.

http://lab.org.uk/an-overview-of-microfinance-in-latin-america

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